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SUBJECT: CHINA'S RURAL POLICIES: UPDATE ON THE STATE OF
PLAY GOING INTO THE CPC THIRD PLENUM

11. (SBU) SUMMARY: The stated focus of the October 9-12 Third Plenum of the 17th Communist Party of China (CPC) Central Committee is rural reform. Scholars continue to debate China's current path of rural reform and doubts remain about implementation and whether China's current policy direction addresses fundamental problems in the countryside. Concerns about broader economic issues may be discussed internally at the Third Plenum, and except for possible progress on land policy, the Plenum may serve primarily to reinforce ongoing efforts to increase rural incomes and address the urban-rural income gap. But rural sector economic issues are nonetheless likely to be an important factor weighing on policymakers' minds given concerns about the implications of a slowing global and domestic economy on rural stability. END SUMMARY.

12. (SBU) With the Third Plenum of the 17th CPC Central Committee scheduled for October 9-12, the official Chinese press has carried numerous articles and commentaries penned by prominent scholars on various ongoing rural reform efforts (Ref A), including new measures that may be introduced and adopted at the Plenum. Rural policy experts have also commented on ongoing rural policy debates in recent meetings with Econoff. This cable provides background on the rural economic policy issues that are likely to part of any Plenum deliberations on rural issues specifically, as well as any internal deliberations at the Plenum on economic growth and financial stability (Ref A). See Ref B for recent reporting on food security, which is also expected to be on the Plenum agenda.

The New Socialist Countryside: Progress Overshadowed by
Rising Inequality and Stability Concerns

13. (SBU) For the past five years, rural issues have been the focus of China's No. 1 central documents -- the name given to the first document issued by the Central Committee of the Communist Party and the State Council each year. The New Socialist Countryside and related policies covered by these documents emphasize promoting rural farmers' interests and rural economic and agriculture development through agriculture subsidies, tax cuts, cutting tuition and school fees for rural residents, and improving the rural social safety net (e.g., education, medical care, pensions). These policies also include efforts to balance and coordinate urban and rural development (including through gradual rural-urban migration and reforms to the hukou system) as well as commercializing agricultural production and linking farmers to domestic markets.

¶4. (SBU) Chinese Academy of Social Sciences (CASS) scholars told Econoff that recent surveys show broad satisfaction among rural residents with agricultural subsidies and rural healthcare policies. And on August 28 China's Minister of Agriculture Sun Zhengcai claimed per capita income in rural China rose 10.3 percent in the first half of 2008, the largest six-month period increase in four years. Rural residents' average net income for the six month period was 2,528 yuan (USD 370). This follows a 9.5 percent annual increase in 2007, the largest since 1985.

¶5. (SBU) In the same report, however, Sun also reported that the per capita income gap between rural and urban residents expanded to 1:3.33 and the net income difference reached 9,464 yuan (USD 1,382), the largest income gap since 1978. Although the growing income gap was expected, local observers and press commentary focused on the bad news, and scholars repeatedly emphasize the need to address the growing urban-rural gap in incomes and social services. They also emphasize the threat to social stability that would result from mishandling rural sector issues in meetings with Econoff.

¶6. (SBU) The New Socialist Countryside policies have been accompanied by large increases in fiscal expenditures. But scholars such as Yang Tuan at CASS explain that funds do not make it to the most marginal, needy rural areas. In late July the Audit Bureau published the results of a survey of 50 counties in 16 provinces highlighting mismanagement and misallocation of Central Government transfers to provinces for rural development. According to the report 32 percent of funds allocated for projects

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required more than one year to be spent. A separate 2003 Audit Bureau survey of 50 counties found that 10 percent of Central Government rural development funds were misallocated. Contacts at the Asian Development Bank and World Bank explain that the central government lacks the basic technical tools (e.g., databases) as well as institutional capacity, to track and monitor the use of rural development funds. The Central Government's lack of budget execution capacity often results in funds being used for more immediate and easily executed expenditures such as cadre salaries and infrastructure projects in provincial capitals.

¶7. (SBU) Problems implementing rural development programs and abuse by local officials are also being reported on by the domestic press. Beijing's Xinjing Bao, the prominent Party-run mass circulation daily, highlighted a case in Henan Province last month in which inappropriate harvesting fees were imposed on peasants in the middle of the corn harvest season. After the case came to light in the press the local village government returned the fees.

Land and Property Rights: Gradual Progress?

¶8. (SBU) Hong Kong and Chinese press (Ref C) reports on the Third Plenum predict reforms aimed at clarifying and strengthening peasants' land rights, but no one is predicting privatization. According to press articles in late September, a policy has been drafted for the Plenum that will greatly reduce the ability of local governments to obtain land from farmers for real estate and infrastructure projects without fair compensation. The story also notes that local governments will likely resist these reforms because they rely heavily on the large revenues they earn from developing real estate on land they confiscated without paying appropriate compensation.

¶9. (SBU) Rather than advocating land privatization, press commentary by prominent scholars (Ref A) focuses on extending land use rights or making them permanent,

addressing problems with fair compensation for land confiscated by local governments, clarifying farmers' rights to transfer land use rights, creating a dispute resolution mechanisms for land confiscation disputes, and clarifying "public good" and the fair price landholders are assessed in the eminent domain land confiscation process. The proposals also aim to solidify land use rights in order to make it easier to use these rights as an asset that can be mortgaged or transferred or "circulated" (Ref C) in ways that provide an income stream to the land use right holder.

¶10. (SBU) In meetings with Econoff, Xu Xiaoping from the State Council Development Research Center (DRC) commented that since implementation of new legal protections implemented in the last two years, outright land grabs by local governments has decreased dramatically. Forty million farmers have been compensated in some way for having their land confiscated, according to Xu, although the number of illegal land confiscation cases is much higher since many go unreported and uncompensated. Although the number of incidents may have decreased, Dang Guoying from CASS and others emphasize that disputes over land are the primary cause of rural instability and therefore a key concern for the government.

Specialized Rural Cooperatives: Not Everyone is on Board

¶11. (SBU) Scholars point out that since decollectivization and the start of market reforms peasants have lost the support of strong rural institutions with the capacity to protect their economic interests. To fill the void rural specialized cooperatives are being promoted to help rural farmers commercialize production and gain access to technology and market information. Specialized cooperatives are usually organized around a single commodity and in most cases have an exclusive relationship with a single "dragonhead" enterprise that links farmers to the market. (Note: "Dragonhead enterprises"--longtou qiye--are relatively large-scale rural enterprises that can integrate farmers into their supply chains and provide

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access to inputs and market information while also providing a sales outlet. End Note.) The two entities coordinate closely and may share managers. New laws implemented in 2007 and 2008 are helping the development of cooperatives by clarifying registration and internal management procedures.

¶12. (SBU) Recent visits by President Hu Jintao to Henan and Anhui as well as press commentaries (Ref C) highlight the contributions of specialized rural cooperatives. But in a recent meeting with Econoff, Henan Agricultural University's Zhang Dongping highlighted the lack of transparent and fair decision-making and the dominant role of the dragonhead enterprises in the management of cooperative affairs. Zhang also admitted that cooperatives are not themselves a poverty alleviation tool for remote rural communities without easy access to markets and a local entrepreneur or dragonhead enterprise that can provide the link to outside markets. An October 6 story in the Xinjing Bao about the village Hu Jintao visited September 30 mentions that villagers in a specialized cooperative were disadvantaged by the pricing power of the single dragonhead enterprise they sold to. The cooperative subsequently broke ties to that company so it could sell directly to multiple dragonhead enterprises. Xinjing Bao also gave extensive coverage to a July incident in Yunnan involving a dispute between local rubber farmers and dragonhead enterprises over prices and contract obligations to sell harvests exclusively to the enterprise. The clash left two villagers dead.

¶13. (SBU) Although the specialized rural cooperative model

is the main policy focus, a number of scholars including Renmin University's Wen Tiejun, China Agricultural University's He Huili, and CASS's Yang Tuan argue that comprehensive village cooperatives that include village members involved in a range of economic activities serve the farmers' interests better than specialized cooperatives. According to Yang, specialized cooperatives only provide cover for bellwether companies or rich individuals to get ahead and only have the faade of a cooperative. They prefer the participation of truly grassroots efforts with varying degrees of government and/or outside (e.g., domestic and international NGO) support. Although these ideas are not in the policy mainstream, these scholars are involved in demonstration trials in various rural locales and are active in Beijing policy debates.

Rural Finance: Will Current Reforms Matter without Land Privatization?

¶14. (SBU) According to Xu Xiaoqing the land issue is key to fixing rural finance. Although privatization of land is not in the cards, some localitis in Anhui, Shandong, and Zhejiang are allowig farmers to use certificates verifying long-term rights to residential land (though not their fields) as collateral, and forest land in som areas can also be used as collateral for bank loans.

¶15. (U) The People's Bank of China's (PBOC) Rural Financial Services Report released on September 19 did not include groundbreaking recommendations on the use of land as collateral, but did discuss measures to work around this constraint such as expanding the ability of rural residents to use contracts to deliver harvests to dragonhead enterprises and other non-real assets as collateral for loans. The report highlights efforts to improve credit rating systems for individual borrowers and recommends removing interest rate cap on loans to make lenders more profitable and help increase incentives to increase rural banking services. The report also notes commitments by the Agricultural Bank of China as part of its restructuring efforts to expand its rural banking services, which shrank over recent years.

¶16. (SBU) Removing the interest rate cap would be an important step. But many observers emphasize that without significant progress on the land issue it will be difficult to expand the availability of rural banking services to the majority of rural residents. The PBOC's report focuses on expanding financial services for dragonhead enterprises and well-off agricultural entrepreneurs, and not poor peasant

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farmers. Scholars such as Wen Tiejun and He Huili argued in recent meetings with Econoff that comprehensive village cooperatives (not specialized cooperatives) are needed because they can provide cooperative rural financial services that are more appropriate for rural communities in which land can not be used as collateral and information on individual creditworthiness is lacking.

Comment

¶17. (SBU) Many of the policy alternatives to current rural reforms cited by our contacts are inconsistent with the broader goals of increasing efficiency and the role of the market. Given the need to make rural banking financially viable, for example, even the most successful rural finance reforms may never reach the extreme rural poor. Government and donor-supported micro-finance programs are probably more viable than cooperative banks as a solution to the lack of financial services available to the poorest rural residents. Likewise, a return to more socialized rural

organizations due to concerns about income inequality, the dominant role of dragonhead enterprises, and mismanagement in rural specialized cooperatives would hurt broader reform and economic growth efforts. Nevertheless, the problems raised by our contacts reflect sources for rural unrest and therefore need to be addressed in the name of maintaining social stability.

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